Statement of
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Foreign Investment in U.S. Air Carriers

Good afternoon. I am Duane Woerth, the President of the Air Line Pilots Association. ALPA represents over 62,000 pilots at 39 airlines in the United States and Canada. We appreciate the opportunity to appear before this Subcommittee today to present our views on the U.S. Department of Transportation's proposed policy on foreign control of U.S. airlines that is linked to that text. While DOT has recently modified that proposal, we continue to have deep reservations about several of its substantive provisions and believe that Congress, rather than the Department should determine the rules that apply to the ownership and control of U.S. airlines. We fully support S. 2135, which is designed to ensure that Congress has an opportunity for meaningful review of DOT's proposal and its implications, as well as Senators Inouye and Stevens' proposed amendment to the supplemental appropriations bill that would prohibit the issuance and implementation of DOT's proposed rule through the end of fiscal year 2006.

Background - The Proposed U.S. – EU Text

DOT's proposal is closely tied to the text of a possible air services agreement that was initialed by the U.S. and the European Union last year. In fact, the E.U. has expressly linked the outcome of DOT's rulemaking process to the E.U.'s decision to finally accept or reject that initialed text. Accordingly, as a preliminary matter it is important to assess the contents of that text.

ALPA believes that the initialed text offers little to U.S. airlines, but much to their EU counterparts. That text would allow any European airline to fly from any point in Europe to any point in the U.S. and beyond. For example, Lufthansa could fly from Paris to Atlanta; Air France could fly from Munich to Chicago. Thus, the initialed text would solve the problems raised for the Member States of the European Union by the December 2002 European Court of Justice decision that found that the ownership and control clauses in the bilateral agreements between the United States and individual European Member States were illegal because they violated the right of establishment provisions of the EU's organizational statutes. The text would also facilitate the consolidation of European airlines, potentially allowing them to be more efficient and effective competitors vis a vis U.S. carriers. In addition, under the initialed text EU carriers would receive the right to provide aircraft and crew to U.S. airlines on international routes, a right they have long sought, but which appears to be in square violation of the Federal Aviation Regulations and directly threatens the jobs of U.S. airline pilots. Clearly the initialed text provides substantial benefits to EU carriers.

What would U.S. carriers get if the initialed text were to go into effect? Apart from some additional routes beyond European gateway points that our cargo carriers might use, not much. In June 2004, the U.S. Government Accountability Office issued a report titled "Transatlantic Aviation: Effects of Easing Restrictions on U.S.-European Markets." That report contained an assessment of what U.S. carriers and consumers stood to gain if the U.S. entered into an "open skies" agreement with the EU that eliminated, as does the initialed text, the nationality restrictions on EU carriers. The GAO concluded that whatever benefit U.S. carriers and consumers would eventually gain from such an agreement would not be realized for several years. This, according to the GAO, is because the U.S. already has open access to the vast majority of European traffic and the only significant restricted market -- London -- is subject to significant airport capacity constraints that would not be eliminated by a liberalized agreement. In other words, in the GAO's view, U.S. carriers were not likely to benefit in the short term and possibly only to a small extent even in the longer term by a US-EU "open skies" agreement similar to the initialed text.

But as favorable as the initialed text is for European carriers, they want more. Throughout the negotiations the European carriers sought the inclusion in any new agreement of the right for them to own and control U.S. airlines. DOT's proposal is the Department's effort to satisfy this E.U. objective.

The Foreign Control Rulemaking

So let me turn to that rulemaking process and DOT's proposed policy change.

The Department's proposal was first issued on the eve of the round of negotiations that resulted in the initialed text. After reviewing the comments that were submitted on the proposal, DOT issued a supplemental proposal last week. That revised proposal would permit foreign interests to exercise actual control over all the commercial elements of a U.S. air carrier's business, including, apparently, such fundamental matters as the "definition of and quality of product, branding, fleet mix, origins and destinations, [and] network issues defining the business of the company." Under the proposal U.S. citizens would have to maintain actual control of only four areas:

1. The carrier's "organizational documentation, including such documents as charter of incorporation, certificate of incorporation, by-laws, membership agreements, stockholder agreements, and other documents of similar nature;"

2. The carrier's "decisions whether to make or continue Civil Reserve Air Fleet (CRAF) or other national defense airlift commitments, and, once made, the implementation of such commitments with the Department of Defense;"

3. The carrier's "policies and implementation with respect to aviation security, including transportation security requirements specified by the Transportation Security Administration;" and

4. The carrier's "policies and implementation with respect to aviation safety, including requirements specified by the Federal Aviation Administration."

As long as these four areas remain under U.S. control -- and the other requirements of the statute relating to place of incorporation, ownership of voting stock, and the citizenship of managers and directors, are met -- the Department would permit foreign citizens to control all other commercial elements of the carrier's business and operations. As United Airlines CEO Glenn Tilton put it in a recent speech the proposal "would allow foreign investors in U.S. airlines to effectively control the bulk of the airline's commercial operations."

We do appreciate DOT's consideration of the comments that were filed on the initial proposal and the Department's efforts to be responsive to some of the expressed concerns. We intend to look at the supplemental proposal closely and file our comments at the appropriate time. But even on a first reading, we believe there continue to be a number of flaws in the Department's proposal.

<u>The Statutory Issue</u>

First, even as revised, DOT's proposal is simply at odds with Congress's determination that actual control of a U.S. air carrier must be in the hands of U.S.

citizens. The four areas over which the Department would continue to require U.S. citizen control is important, but it is ultimately peripheral to an airline's core business operations and strategy. Control over the four narrowly defined areas simply does not add up to the "actual control" of the entire air carrier as required by Congress. The most critical issues that managers of a U.S. airline must address are such matters as the markets to be served, the type of aircraft to be flown, the alliances to participate in, the extent to which the carrier out-sources maintenance and other services, the carrier's schedules, fares, etc. These are the fundamental economic decisions that determine the very nature of an airline's operations, and its role in the air transportation system. In fact, DOT's "actual control" test has been focused on the ability of foreign entities to control the economic and operational aspects of U.S. airlines. To permit these matters to be controlled by foreign citizens, as the Department proposes to do, simply cannot be reconciled with the statutory requirement that U.S. citizens retain "actual control" of the airline.

DOT's NPRM acknowledges that, unless Congress changes them, the Department cannot alter the statutory standards that define a carrier's U.S. citizenship -- i.e., the requirements relating to place of incorporation, ownership of the voting stock, and the citizenship of managing officers and directors -- because they are mandated by law. The same is true of the "actual control" requirement. Indeed, the underlying purpose of all the statutory requirements is to ensure that U.S. citizens retain actual control of a U.S. airline. Without "actual control," the other statutory requirements are meaningless.

DOT's supplemental notice states that "all delegations [of control] to foreign interests ultimately be revocable by the board of directors or shareholders." But this proposed "fix' does not address the fundamental problem – that foreign entities will be permitted to be in actual control of key economic and operational aspects of U.S. airlines. The U.S. aviation statutes simply do not allow the dissection of airlines into components that can be under foreign control and those that cannot: the entire airline must be under U.S. citizen control.

Application of the "actual control" standard does require analysis of the specific facts and circumstances of each particular case and thus the Department does have some discretion to define the criteria for determining <u>whether</u> U.S. citizens have "actual control" of a carrier. That discretion, however, does not give the Department authority to change the plain meaning of the term "actual control" itself, so that control over such basic matters as a carrier's route selection, fare structure, or choice of aircraft is simply excluded from the definition of "actual control." This is not interpretation but legislation, and it is the province of Congress, not the Department.

Apart from the legal issues there are a number of policy issues raised by the Department's proposal.

The Impact on U.S. Airlines and Jobs

A key policy issue, in our view, is whether foreign air carriers should be permitted to acquire or exercise the kind of control over the basic business decisions and strategy of U.S. air carriers that the proposed rule change would permit.

Remarkably, the NPRM does not address this issue at all. Rather, it speaks throughout of hypothetical foreign investors in U.S. carriers, without any effort to distinguish between investments by foreign air carriers and other potential sources of foreign capital. But the distinction is of crucial importance.

When one air carrier seeks to acquire control of another, the goal of the acquisition is almost always to combine the operations of the two carriers so as to create an integrated network. Since foreign carriers cannot operate domestically, the reason a foreign carrier would seek control of a U.S. carrier would normally be to combine the U.S. carrier's domestic services with the foreign carrier's international services. While this also occurs when U.S. and foreign carriers form alliances, an acquisition of control is very different from an alliance. In an alliance each carrier remains autonomous and able to protect its own economic interests. A very different situation would be created if a foreign carrier is permitted to acquire control of the key economic elements of a U.S. carrier's business strategy -- such as route structure, schedules, fleet type, and the like. In such a situation, it is inevitable that the foreign carrier would exercise its control to maximize its own interests, not those of the U.S. carrier.

What would likely happen when a foreign carrier acquires control of a U.S. carrier is that the foreign carrier might well use the U.S. carrier to create a domestic network that would support and feed traffic to the foreign carrier's international operations. As a result, any pre-existing international operations of the U.S. carrier could diminish or disappear, while those of the international carrier would be expanded.

Such a result is fundamentally inconsistent with 49 U.S.C. § 40101(a)(15), which sets forth as a U.S. policy goal:

> strengthening the competitive position of [U.S.] air carriers to at least ensure equality with foreign air carriers, including the attainment of the opportunity for [U.S.] air carriers to maintain and increase their profitability in foreign air transportation. [Emphasis added.]

This goal simply could not be accomplished if foreign carriers are permitted to control the basic operations and business strategy of U.S. carriers.

The decline in international operations by U.S. carriers that would result from foreign control would also undermine the CRAF program, because it would necessarily cause a reduction in the number of long-range wide-bodied aircraft in the U.S. carrier's fleet. Although the Department's proposed rule attempts to protect the CRAF program by ensuring that U.S. citizens retain control of a carrier's CRAF commitments, the fact is that a foreign carrier that has economic control of a U.S. carrier would be able to determine how many CRAF-eligible aircraft the U.S. carrier has in its fleet. And it is predictable, for the reasons stated, that the foreign carrier's business strategy would cause that number to diminish over time.

The decline in international operations by U.S. carriers would also be injurious to U.S. airline workers, including in particular the pilots. International flying of wide-bodied aircraft is the most remunerative, and therefore the most desired, flying performed by pilots; pilots spend their entire careers accumulating the seniority required to gain access to such flying opportunities. In an era when the career expectations of pilots and other airline workers have already been repeatedly frustrated by airline bankruptcies, furloughs, wage concessions, pension plan terminations, and the like, it would be a crowning blow for the U.S. government now to adopt a policy that would tend to eliminate international flying by U.S. carriers.

U.S. workers would also suffer injury because U.S. labor laws do not apply to foreign air carriers. When two or more U.S. carriers are commonly controlled, the employees of all of them are subject to the Railway Labor Act and therefore have the same collective bargaining rights and opportunities. This allows the employees on all the affiliated carriers to try to equalize their wages and working conditions, thereby preventing the carriers from playing one employee group against another. When one of the affiliated carriers is foreign and therefore not subject to the same labor law, the employees of all the affiliates are placed at a severe disadvantage and face the prospect of being bid against each other without effective recourse against the entity (perhaps a foreign holding company) that is allocating the work. These are not hypothetical concerns. In the early 1990s when British Airways bought into US Airways, and KLM bought into Northwest, flight crew jobs were either moved to or grew disproportionately at the foreign partner.

The validity of these concerns was recognized recently by a Working Group appointed by the American Bar Association's Air and Space Forum to study the issue of whether the statutory restriction on ownership and control of U.S. airlines. The Working Group issued a Proposed Position Statement (attached hereto) which, despite being favorably disposed to lifting the restrictions on foreign ownership and control of U.S. carriers, clearly recognized that ownership or control by foreign airlines should not be permitted until and unless special safeguards are enacted. The Working Group therefore recommended adoption of two important restrictions on foreign air-carrier control of a U.S. carrier. The first of these restrictions would require any foreign carrier that acquired control of a U.S. carrier to:

> ensure that the U.S. airline maintains at least the percentage of the combined total ASMs operated by both the U.S. airline and the foreign affiliates between the United States and any country or region that it had as of a date six months prior to the announcement of the acquisition. This condition ensures that the CRAF program has access both to a sufficient number of the appropriate (i.e., long-haul wide-body) aircraft and to the crew necessary to fly them in a military emergency. It simultaneously ensures that U.S. jobs are not transferred to foreign entities.

The second restriction proposed by the ABA Working Group would require that "[t]he U.S. government and the appropriate foreign government(s) . . . establish in advance a legal framework containing fair procedures to regulate labor representation and collective bargaining on such multinational airline systems." The purpose of this recommendation, of course, is to eliminate the unfair advantage that would otherwise result if the U.S. carrier and the foreign carrier were subject to different rules relating to labor representation and collective bargaining.

While ALPA does not endorse the Proposed Position Statement of the ABA Working Group, we do believe the statement has at least identified the basic concerns that must be addressed if any change is to be made in existing rules relating to foreign ownership or control of U.S. air carriers.

In its supplemental notice DOT attempts to address some of these concerns. We will examine and respond fully to DOT's suggestions in our comments on the supplemental notice. However, we would make some preliminary observations.

First, DOT states that even if foreign entities control the operations of a U.S. airline that airline would still be subject to the Railway Labor Act and thus "all employees at any U.S. carrier would retain all the protections created by United States' labor laws." But that fact has never been at issue. The concern, as stated above, is that U.S. labor laws may be inadequate to deal with the job allocation issues that may arise if two airlines subject to two separate sets of labor laws are under common ownership.

Second, DOT concludes that if a foreign investor who had been delegated authority to control of a U.S. airline were to shift long-haul flying to a foreign carrier U.S. investors would withdraw the delegation of authority if the transfer was contrary to the interest of the U.S. carrier and the U.S. citizen investors. The conclusion simply does not square with the reality of how board rooms work, especially in a publicly-held company where the foreign investor may be far and away the largest and most dominant shareholder. Moreover, while DOT discusses at length the right of U.S. shareholders or board members to revoke authority from foreign investors, the Department's actual policy (which is only a page long) says nothing about this right. Exactly, how the right would be enforced is obscure.

Third, DOT proposes to revise its initial proposal by requiring that U.S. citizens must control a U.S. carrier's commitments with respect to all national defense airlift operations. But the Department's supplemental rule does not address the fact that a foreign investor would be able to make fleet decisions that could eliminate all the aircraft suitable for CRAF operations. In other words, while U.S. citizens may have to have control over honoring CRAF and other national defense airlift commitments once made, a foreign manager could make fleet decisions that leave no aircraft available for the commitment in the first place.

<u>The Impact on Safety</u>

DOT's supplemental proposal discusses a number of safety concerns raised by ALPA and other commentators and proposes to broaden the language of the initial rule to clarify that "U.S. citizens must control the carrier's overall safety and security programs and policies, not just the carrier's compliance with the requirements of the FAA and TSA." ALPA will review DOT's assessment and file comments on the revised proposal. However, ALPA notes that safety and security issues are completely intertwined with operational and economic decisions and that whoever actually controls the operations of the airline is likely to ultimately control safety policies and implementation.

<u>The Lack of Supporting Data</u>

Finally, the Department has presented no data either to support its claim that the U.S. airline industry is in need of more foreign investment, or its claim that such investment is not available absent a change in the foreign control rules. We believe that the fundamental premise on which the supplemental NPRM appears to be based -- that the U.S. airline industry is in need of enhanced access to worldwide financial resources, and that such access to foreign capital cannot be achieved without granting foreign investors substantial control of U.S. carriers -- is erroneous. Certainly, the proposal contains no hard data to substantiate these propositions, and we are not aware that any such data are available.

In fact, there is evidence that when a U.S. airline shows some significant promise of profitability, it is able to find the capital it needs. For example, United Airlines, after engaging in extensive restructuring, cost-cutting and changes in operations and services while in Chapter 11, was able to obtain $3 billion in debt exit financing on terms that pleased United's management. The airline's own press release stated that it had received offers of subscription for more than twice the capital necessary to support the financing it sought and that the money was provided at rates better than it had expected to receive. Similarly, US Airways, after going through its own Chapter 11 restructuring and merging with America West, obtained $1.5 billion in exit financing, of which $350 million was in the form of equity commitments. Moreover, $75 million of the equity was foreign investment provided by ACE Aviation Holdings, the parent of Air Canada. These major financings strongly indicate that both foreign and domestic capital is available to U.S. airlines if they appear to offer a reasonable return to the investor.

If there is hard evidence that the U.S. airline industry is seriously suffering from a dearth of capital, and that the existing rules relating to foreign control are somehow responsible for the problem, that evidence has yet to be produced. Before lack of capital is used as a rationale for considering dramatic changes in the foreign control rules, there should be a thorough and systematic study to determine whether the problem it is attempting to cure actually exists.

Conclusion

DOT's proposal is based on two premises, both erroneous. The first is that airlines need enhanced access to foreign capital to be competitive. But as we have shown above, U.S. airlines with sound business planes have been able to find ample capital on reasonable terms. The second is that Congress has decided "the airline industry should be largely deregulated (except of course, for safety and security regulation)." But the airline industry remains regulated in myriad ways and just as safety and security have not been deregulated, Congress has not deregulated airline citizenship - if anything, Congress has recently tightened the citizenship rules. DOT's proposed rule essentially rewrites these rules. The Department's proposal could have broad, potentially negative effects on the competitive posture of US airlines and their employees and raises a number of key public policy issues that have not been adequately addressed by the Department. Consideration of changes of this magnitude should be undertaken not by an administering agency but by Congress. S. 2135 is thoughtfully designed both to afford time for Congress to consider whether a change to the control rules is appropriate and to help develop a record on which that consideration can be based and Senators Inouye and Steven's amendment to the supplemental appropriations bill would freeze further action by DOT while that bill moves forward. We urge this Committee to support these measures and to ensure that the DOT does not unilaterally impose changes to the longstanding rules on "actual control" of U.S. airlines.